



The Ohio Supreme Court issued its decision in *Transtar Electric, Inc. v. A.E.M. Electric Servs. Corp.*, Slip Opinion 2014-Ohio-3095 on July 17, 2014. Although it does not change the underlying principles with respect to pay-when-paid vs. pay-if-paid provisions, the Court's decision announces a bright-line rule that should simplify the issue.

PAY-WHEN-PAID VS. PAY-IF-PAID

Generally, there are two types of contractual provisions that control how a general contractor pays a subcontractor. A pay-when-paid provision provides for a general contractor's unconditional promise to pay the subcontractor, usually within a reasonable time to allow the general contractor to be paid. Conversely, a pay-if-paid provision provides for a general contractor's *conditional* promise to pay the subcontractor *only if* the owner pays the general contractor, thereby shifting the risk of the owner's nonpayment to the subcontractor.

Ohio courts have long held that in order to qualify as a pay-if-paid provision, the contract language must explicitly indicate that the parties intended that payment from the owner to the general contractor shall be a *condition precedent* to the general contractor's obligation to pay the subcontractor. However, there was no bright-line rule to determine what contract language was sufficiently explicit to meet that standard. The *Transtar* decision creates such a bright-line rule.

"CONDITION PRECEDENT" IS THE BRIGHT-LINE RULE

In *Transtar*, the general contractor, A.E.M., entered into a subcontract with Transtar for electrical services. The subcontract provided, in relevant part, as follows:

RECEIPT OF PAYMENT BY CONTRACTOR FROM OWNER FOR WORK PERFORMED BY SUBCONTRACTOR IS A CONDITION PRECEDENT TO PAYMENT BY CONTRACTOR TO SUBCONTRACTOR FOR THAT WORK.

A.E.M. refused to pay Transtar's final three invoices because the owner had not paid A.E.M. When Transtar filed suit, A.E.M. defended on the basis of the contract language, arguing that it was an enforceable pay-if-paid provision. The trial court agreed, but the Sixth District Court of Appeals reversed, holding that "[i]t must be made plain, in plain language, that a subcontractor must look to the owner for payment[.]" and the language in the A.E.M.-Transtar contract does not meet that standard.

In a 5-2 decision, the Ohio Supreme Court reversed, finding that "[t]his provision means just what it says—that [the contractor's] duty to pay [the subcontractor] is expressly conditioned on its own receipt of payment—thus evincing the parties' unambiguous intent that each party assumes its own risk of loss if [the owner] becomes insolvent or otherwise defaults." Perhaps more importantly, the Court held that "the use of the term 'condition precedent' negates the need for additional language to demonstrate the intent to transfer the risk."

Thus, the *Transtar* decision provides certainty where previously there was much confusion. General and subcontractors alike, as well as contract drafters, now know that the use of the term "condition precedent" creates a valid and enforceable pay-if-paid provision. Such a bright-line rule should simplify contract drafting, negotiation, and enforcement.

For assistance in evaluating whether your label complies with the Supreme Court's new ruling, please contact one of the attorneys listed below.



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